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SIPDIS

TREASURY FOR FTAT AND OFAC
TREASURY FOR OCC/EILEEN SIEGEL
TREASURY ALSO FOR OASIA/ICB/VIMAL ATUKORALA
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SUBJECT: Austrian Euro 100 billion package for banks

REF: (A) VIENNA 1484; (B) VIENNA 1454

¶1. Summary: In accordance with the October 12 EU agreement, the GoA proposed a Euro 100 billion (\$135 billion) "rescue package" for Austrian banks on October 13. The Government Council (cabinet) approved the corresponding legislative proposal on October 14. The plan includes Euro 85 billion (\$115 billion) in government guarantees for inter-bank lending and a Euro 15 billion (\$20 billion) guarantee to strengthen the banks' capitalization. The guarantees are surprisingly high compared to other EU countries' measures. Chancellor Gusenbauer, Finance Minister Molterer and National Bank Governor Molterer claimed in unison that the package is only a "precautionary measure," not a bail-out plan for banks. The Vienna Stock Exchange (VSE) experienced an all-time-high rise of over 12 percent on Monday, and a more modest 6 percent rise on Tuesday. End summary

¶2. The GoA's proposal for a Euro 100 billion financial rescue package for Austrian banks is unique for a country of its size -- Austrian GDP was Euro 270 billion in 2007. The package consists of four measures and should be adopted in a special session of the outgoing parliament on Monday, October 20th. The Euro 100 billion guarantees will only be available until end of 2009.

GOVERNMENT "CLEARING POINT" SHALL GUARANTEE BANK LENDING

¶3. The Euro 85 billion guarantee is intended to ensure longer-term liquidity and to re-stimulate credit lending between banks: inter-bank trading had largely ceased in recent days. The government will set up a "clearing agency" to administer the guarantees and bank lending. Loans from one bank to a second bank with liquidity problems will be made through the clearing agency, which will be established from the resources and staff of the Austrian Control Bank. Banks that want to claim government guarantees will also have to take a financial interest in the clearing agency (probably in relation to their balance sheet total), according to the draft law.

GOA CAN NATIONALIZE BANKS IF NEEDED

¶4. The GoA also foresees Euro 15 billion to provide additional equity to banks if needed, so as to strengthen the equity/debt ratio and guarantee bank assets. The GoA will set up a subsidiary to the existing Government Holding Company (OIAG) to work with the money at its disposal. There are two ways for the government to intervene: A) If a bank has a grave liquidity problem, the OIAG subsidiary can buy new shares issued to increase the bank's capital stock. B) If a bank or other financial institution is collapsing, the government can buy existing shares up to 100%. In the case of such a (whole or partial) nationalization, private owners must be compensated. The

draft law foresees that the government shares must be re-privatized "when the capital market situation has been stabilized". The main goal of these measures is to increase the core equity capital quota to eight or nine percent, if needed, the Finance Ministry explained. Gusenbauer said that the government would exercise ownership rights "only under very exceptional and turbulent situations in the financial markets."

UNLIMITED GUARANTEE FOR PRIVATE BANK DEPOSITS

¶5. A third measure -- agreed upon a week ago -- is an unlimited guarantee for bank deposits of private customers (guarantees now cover only Euro 20,000 per customer and bank) retroactive to October 1, 2008. This guarantee could theoretically cost hundreds of billions of euros.

NO MORE SHORT-SELLING AT THE VIENNA STOCK EXCHANGE

¶6. Finally, the package suspends short-selling at the Vienna Stock Exchange, a measure also agreed a week ago: The VSE is authorized to prohibit short selling (ref A) temporarily and/or until revocation for single or all securities traded. In the case of price changes of a financial instrument of more than 10%, the VSE is authorized to suspend trading in such instruments.

¶7. All government officials and the head of the National Bank tried to play down the possibility of taxpayer's money flowing to the rescue of banks. National Bank Governor Ewald Nowotny said the

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guarantees were "a vaccination for the economy". Molterer said that the GoA will do everything possible so that "the package will not become a redistribution of risks and losses from the banks to the taxpayers."

¶8. Two big Austrian banks (Raiffeisen, Erste Bank) welcomed the Euro 85 billion in guarantees. It appears that all major Austrian banks will participate in the clearing agency. A week ago, most Austrian bank CEO's had claimed that their balance sheets were strong enough to avoid any state intervention.

AUSTRIAN BANKS INVOLVED IN THE ICELAND CRISIS

¶9. Meanwhile, some information about Austrian banks' exposure in Icelandic banks, which the National Bank and the Finance Market Authority (FMA) are investigating, came to light. According to unconfirmed press reports the finance sector is worried about assets worth Euro 2.6 billion (\$3.5 billion). Most affected seems to be the Raiffeisen Bank with over Euro 1 billion. In cooperation with other European banks they had granted loans worth Euro 900 million in 2007 to several Icelandic financial institutions. According to a June 2008 Raiffeisen Bank press release, the bank also granted another Euro 275 million loan to Iceland's Kaupthing Bank together with Bayern LB and the Bank of America.

¶10. On October 8, the FMA had issued an administrative decision prohibiting the Austrian branch of Kaupthing Bank from accepting deposits and from transferring any deposits from accounts in Austria. The measure will apply for a maximum of 18 months. Kaupthing Bank had only opened its Austrian branch on September 4, ¶2008.

Economic Stimulus Package

¶11. In another effort to fight the financial crisis, the government agreed on an economic stimulus package to counter the weakening economy (ref A). Detailed information on the measures to support the labor market, stimulate investment and finance infrastructure projects are not yet available and will be worked out during the

next one or two weeks. The placeholder government also plans to seek parliamentary approval for the stimulus package in the parliament's October 28 (or may be even October 20) plenary session.

COMMENT: WHY DO AUSTRIAN BANKS NEED SUCH A STRONG

SAFETY NET?

¶12. Comment: The amount of the Austrian "rescue package" in relation to the GDP is significantly higher than the rescue plans in most other EU countries. The GoA argues that the relative size of the Austrian banking sector compared to the rest of the economy necessitates stretching a robust safety net. The GoA also seems not to expect the guarantees to fall due or to have to put fresh money into the banking sector. Given the leading role of Austrian banks in ailing Central and Eastern European countries such as Romania, Bulgaria and particularly neighboring Hungary, and the significant stake in Iceland, the GoA's assessment could turn out to be wrong. Given that the guarantees account for over a third of the entire Austrian GDP, should the crisis deepen, we would expect major domestic policy implications and cannot rule out spillover effects to the region. End comment

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